Submission to

The House Committee on Ways and Means

Real Estate Working Group

By the Affordable Housing Tax Credit Coalition

April 2013

The Keys to Success of the Low-Income Housing Tax Credit

For more than a quarter century, since the last time the Internal Revenue Code was reformed, the low-income housing tax credit (the "Housing Tax Credit") has been the most successful federal rental housing program in the Nation's history, according to the widely respected housing studies department of Harvard University.[1] Based on its long track record, the program deserves to be maintained as a permanent part of the Internal Revenue Code.

Background of the Housing Tax Credit

In crafting the 1986 Tax Reform Act, Congress made sweeping changes that replaced other tax subsidies for low-income housing, such as substantially favorable depreciation allowances. These provisions were not well coordinated and were difficult for Congress to monitor effectively.. But in doing so, Congress also recognized that the tax code should continue to provide incentives for private sector capital investment in low-income rental housing. Originally passed as a three year program, the Housing Tax Credit, which is contained in Section 42 of the Internal Revenue Code of 1986, was substantially tightened in legislation enacted in 1989 (in consultation between the Congress and industry stakeholders). It became a permanent program in 1993. In our view, the results have exceeded Congressional expectations.

During the life of the Housing Tax Credit, it has produced over 2.5 million apartment homes[2] , housing more than twelve and a half million people[3]. Billions of dollars generated by the Housing Tax Credit

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[1] Joint Center for Housing Studies of Harvard University, December 2009.

[2] National Council of State Housing Agencies (as of December 2011).

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have been invested in local communities by the private sector. In addition, over 95,000 jobs are created annually[4] (a substantial number of which are in small businesses). All of this has been accomplished with a foreclosure rate of less than one percent[5], and with a program that has been termed “highly compliant” by a former IRS official with oversight responsibility for this program.[6]

Operation of the Housing Tax Credit

The Housing Tax Credit produces and preserves affordable rental housing—both newly constructed and existing housing which is substantially renovated-- for families, seniors, veterans and persons with special needs, all of whom meet certain income limits and pay restricted rents. The property must be maintained as affordable for at least 30 years, although many states require substantially longer restrictions. Although the Housing Tax Credit is a federal income tax credit, the primary responsibility for the allocation of credits and the oversight of the properties receiving these credits is vested with each state, generally the state’s housing finance agency (although the cities of New York and Chicago and certain territories each administer the program in their respective jurisdictions).

Each state is authorized to allocate federal Housing Tax Credits, which are allocated to the states via a population based formula (with a minimum allocation for smaller states), pursuant to a “qualified allocation plan” that the state adopts under broad federal guidelines and which is developed with public input. This decision making, given to the states under the tax code, allows each state to determine the best use of this federal support. Developers in each state compete—and compete vigorously—for this scarce resource; most states report that the demand for such credits outstrips supply by significant margins.

Allocation decisions are transparent and subject to public scrutiny. Once awarded, developers seek investors, who are now comprised almost entirely of large corporations, to invest either directly or

[3] This number is based on the assumption that the 2.5 million units are occupied by 2.5 persons per unit and that during the life of that unit, the occupants have turned over at least once (which assumption is very conservative).

[4] National Association of Home Builders, February 2013.

[5] CohnReznick LLP, December 2012.

[6] Statement of Susan P. Reaman, former Branch Chief of the Internal Revenue Service Office of Chief Counsel, shortly after her retirement, in remarks to the Affordable Housing Tax Credit Coalition in January 2008 (Ms. Reaman is at present of counsel at Nixon Peabody LLP).

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through organized syndicates. Such investors make capital contributions, which help fund the project's development costs, in exchange for an ownership interest in the property. That ownership interest allows the investor as taxpayer the right to be allocated the Housing Tax Credits which are generated by the rental property in which they are investing their capital.

The incomes of the households or individuals residing in Housing Tax Credit developments cannot exceed 60 percent of the area median income where the property is located (although there are adjustments for family size consistent with other federal housing laws). The residents pay restricted rents, which are based on applicable income limits and the number of bedrooms in their unit. Properties must meet strict habitability standards. Significant recapture penalties apply for fifteen years in the event of non-compliance with the income, rent, habitability or other program rules although the credit itself is claimed over a ten year credit period. States are required to monitor compliance throughout the fifteen year compliance period.

In allocating credits, federal law demands that each state allocate the minimum amount of credits the state deems necessary for the project's feasibility and its long term viability. The state makes this allocation after determining the project's other sources of financing, its revenue and other subsidies. Although the Housing Tax Credit is almost never the only financing mechanism, it is almost always a significant part of the resources in financing affordable rental housing developments over the past twenty-seven years.

The credit calculation takes into account, among other things, the cost basis of the property and whether or not the project receives tax-exempt debt financing (which lowers the credit percentage).

The private sector financial markets for Housing Tax Credits have been strong during almost all of the program's life and have rebounded substantially from the dislocation that occurred when two of the industry's biggest investors, government-sponsored enterprises, suddenly left the market almost five years ago. The amount of capital that is contributed in exchange for such credits, which is driven by market forces generally, has also greatly contributed to the efficiency of the program. For some projects, the capital contributed exceeds the actual amount of the total Housing Tax Credit stream (because investors can also take into account allowable depreciation deductions as a tax benefit).

One of the best features of the program is that the credits are not allowable to the taxpayer/investor until the property has been completed and placed in service for federal tax purposes and is actually and continually occupied by qualified tenants. As a result, construction and lease-up risk, which in any real estate related investment is the greatest time of risk, is borne entirely by the investor and not by the federal government or its taxpayers. That program feature sends powerful incentives to finish the project as planned and significant penalties if the job is not completed as promised.

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Effectively, the private sector is agreeing with U.S. taxpayers that it will not receive the benefits of the Housing Tax Credit unless and until it produces "qualified low-income housing buildings"[7] that, among other things, are:

- completed satisfactorily within statutory time frames,
- financed by Housing Tax Credits that are capped as to amount and awarded by states competitively; and
- occupied by qualified residents who are paying rents which are at or below program limits and residing in apartment homes in which they are proud to live.

And, as pointed out above, these properties are subject to long-term affordability use restrictions and their owners are subject to significant recapture of their Housing Tax Credits if program violations occur.

The Housing Tax Credit is Required for Affordable Housing Development

Almost all of this housing would not be built or preserved as affordable but for the existence of this program. The capital that is invested as a result of a property qualifying for the Housing Tax Credit is combined with other sources of financing, some of it mortgage debt, to provide sufficient sources in light of project costs. The capital that is infused results in less mortgage debt and debt service and it thereby lowers the cost to operate and finance the project. This feature permits the owner to reduce rents so they are affordable to lower income households. Without the equity capital that results from the Housing Tax Credit, it would not be financially feasible to reduce the rents so they are affordable to lower income residents.

Corporate investors bring tremendous business discipline to the underwriting and oversight of these properties. Quite simply, investors want two things: 1) the benefit of the bargain they are making—they invest significant capital and they expect to receive federal income tax credits in return[8] and 2) they do not want to be embarrassed by investing in failed projects or ones that are not maintained to proper

[7] The singular version of this term defines what must be produced in order to generate low-income housing credits. Code Section 42(a).

[8] Credits reduce federal income tax liability dollar-for-dollar; the investor must have federal income tax liability to benefit as the Housing Tax Credit is NOT a refundable credit.

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standards. To accomplish these goals, investors conduct thorough underwriting and due diligence at the outset and maintain vigorous asset management throughout their ownership, which is typically at least 16-18 years after acquiring its interest in the property. Their ongoing oversight complements the statutorily required monitoring conducted by state credit allocating agencies.

The Need for Affordable Rental Housing is Clear

The Housing Tax Credit is addressing a critical need for more affordable rental housing. Nationally, the gap between the number of available affordable rental homes and extremely low-income households (those with incomes which are at or below 30% of area median income) that need such homes is more than 6.5 million units. Yet only 25% of such households eligible for federal housing assistance receive it.[9] Moreover, fully 25% of all renter households pay more than 50% their income for rent (which percentage grows to 64% for extremely low-income households), according to the Bipartisan Policy Center's Housing Commission ("BPC"). As stated succinctly by the BPC,

> Renters paying excessive shares of income for rent and utilities often have insufficient income available to meet their basic needs for food, health care, education, and transportation—undermining child and adult health and contributing to residential instability that can, among other things, impair education achievement and employment potential.[10]

In other words, there are significant, real and long-term costs that the government is often asked to bear that result from not having an adequate supply of affordable rental housing.

To deal with the severe shortage of affordable rental housing, the BPC recommended that the allocation authority be increased by 50 percent. The BPC estimated that such an increase would support the preservation and construction of 350,000 to 400,000 additional units over the next decade[11].

Need to Re-establish the 9% Housing Tax Credit Floor and Enact the 4% Credit Floor

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[9] Paper submitted in April 2013 to the Ways and Means Working Group on Real Estate by A.C.T.I.O.N. (A Call to Invest in our Neighborhoods), a national grassroots campaign of over 450 organizations. (The AHTCC is a member of this organization).

[10] Bipartisan Policy Center Housing Commission, Housing America's Future: New Directions for National Policy ("BPC Report"), February 2013 at page 84.

[11] BPC Report at page 92.

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In 2008, with the passage of the Housing and Economic Recovery Act of 2008, Congress enacted on a temporary basis an annual floor of 9% with respect to the 70% present value credit. Congress recognized that the credit rate then in effect, which is based on a formula that reflects federal borrowing rates, made many potential developments financially infeasible and made it much more difficult to target to the lowest income residents. That provision originally expired with respect to properties placed in service after December 30, 2013. However, in passing the American Taxpayer Relief Act of 2012, Congress extended the 9% floor for properties which receive a Housing Tax Credit allocation in 2013.

We believe strongly that the current temporary provision for a 9% credit floor should be extended on a permanent basis and that a similar provision should be enacted for the 30% present value credit in order to establish a floor of 4% annually with respect to the acquisition costs in properties in which the Housing Tax Credits are subject to the state's Housing Tax Credit cap (i.e., this provision would not apply to developments financed by the proceeds of tax-exempt bonds). A bill to accomplish these goals was introduced by Congressmen Tiberi and Neal and co-sponsored by 90 Members in the last Congress (HR 3661).

The 9% credit floor has worked extremely well since its enactment in 2008. It has given the states flexibility to award sufficient Housing Tax Credits to make additional developments feasible financially, but only where the need for such Housing Tax Credits can be clearly demonstrated. Very significantly, it has provided certainty for both states and private participants in calculating the projected amount of Housing Tax Credits and the expected equity capital that will be available. Moreover, the ability to award the additional Housing Tax Credits makes it possible to reach the lowest income residents, which is one of the federal priorities set forth in Section 42(m) of the Code.

As noted above, the states are still required to allocate only the minimum amount of Housing Tax Credits that they determine are necessary for the project's feasibility and long-term viability and they are motivated to stretch this scarce federal resource to address as many housing needs as possible throughout their states. If the credit rate is permitted to go back to the formula that existed prior to 2008, it will mean a reduction of approximately 18% in the amount of equity capital that will be available for a given development that qualifies for the 70% present value credit. With respect to the 30 present value credit, enacting a 4% credit floor would increase the amount of equity by approximately 25%[12]. However, continuing the 9% credit floor and enacting a 4% floor should have a negligible budget impact in that such provisions would not increase the overall amount of Housing Tax Credits available.

[12] These figures are based upon the current formula-based credit amounts in effect in April 2013—7.43% for the 70% present value credit and 3.19% for the 30% present value credit.

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As stated in a "Dear Colleague" letter authored by Congressmen Tiberi and Neal in February 2012:

> When combined with the budget cuts at the local, state and federal level, this further cut in resources for affordable housing will make it even more difficult to build and preserve affordable housing, even as the shortage of affordable housing is greater than ever.

We note that the Administration's Fiscal Year 2014 budget contains a proposal that would change the formula for calculating the annual credit percentage for both the 70% and 30% present value credits. We appreciate the Administration's concern about this issue but are still in the process of studying that proposal.

Accordingly, we continue to support the proposal reflected in HR 3661 and hope that similar legislation will be introduced and enacted in the current Congress.

(Conclusion on following page)

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Conclusion

In the end, the real key to the success of the Housing Tax Credit has been a long history of Congressional and executive branch support, from its original enactment to the highly effective legislative improvements and expansions that have been enacted since 1986 in close consultation with all industry stakeholders. It is a program that has had staunch support and advocacy from both Republicans and Democrats in the House and the Senate. Beginning with the Reagan administration, successive presidents have supported the Housing Tax Credit and each has signed legislation that has expanded and improved the program over its life[13].

The Housing Tax Credit is a model program that has been and is supported widely on a bi-partisan basis. Given its long history of success, it is worthy of continuation in the Internal Revenue Code as Congress and the administration consider tax reform proposals.

The Affordable Housing Tax Credit Coalition ("AHTCC") is a trade association that represents syndicators, developers, lenders, institutional investors, nonprofit groups, public agencies, and other allied professionals concerned with the Housing Tax Credit program. The Coalition, a nonprofit corporation chartered under the laws of the District of Columbia, is governed by an elected Board of Directors. It has been deeply involved with the Housing Tax Credit since its original enactment and in connection with all legislative amendments since that time. The AHTCC maintains a website at www.taxcreditcoalition.org.

The AHTCC's address is 401 9th Street, NW, Suite 900, Washington, DC 20004. Phone number [redacted] For further information, please contact AHTCC's general counsel, Richard Goldstein, [redacted]) or AHTCC's legislative counsel, James Miller, at ([redacted]

[13] President Reagan signed the Tax Reform Act into law in 1986. President George H.W. Bush signed legislation that substantially tightened and improved the Housing Credit in 1989. President Clinton signed legislation making the program a permanent part of the Internal Revenue Code in 1993 and in 2000 he signed a bill that expanded by 40% the amount of available credits. President George W. Bush signed legislation in 2008 that updated the law and provided additional flexibility for program participants. President Obama signed a bill in 2009 that temporarily assisted the program during the financial crisis that began in 2008.

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